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Institutions, incentives and social policy in the 'Dutch model'

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Abstract

In this paper we discuss the Dutch social-economic model that has proved so successful in recent years. We pay special attention to the reform of the social security system and to the role of formal Institutions for Policy Coordination. The Dutch experience learns that in redesigning social security systems or facilitating macro-economic adjustment, a dialogue between unions, employers' organizations and the government is a valuable asset. Countries that expand existing collective social security schemes or introduce new schemes should pay close attention to possible adverse labor market incentives associated with badly designed programs. Collective social insurance of the European kind might not be the best way to achieve income protection for countries with a high share of workers employed in the informal sector. We discuss individual accounts as a possible alternative and conclude that both social security principles have their pros and cons. Developing a system of social security that combines these two approaches could very well be the best way to pursue for developing countries seeking to expand income protection for their workforce.

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1 — Introduction

As part of the process of European unification, policy makers, politicians, opinion leaders and others from civil society feel a rising need to explore and learn from social and economic policies in other member countries. Triggered by its economic successes in recent years, a great deal of the attention is focused on The Netherlands. Two elements of what has been labeled the 'Dutch model' receive most attention: the reform process of the system of social security and the functioning of so called Institutions for Policy Coordination.

The Netherlands has proven most ambitious and successful in redesigning social security. The process of reform started in the 1980s and has gradually shifted from cost reduction towards institutional and governance adjustments. The reform of the social security system in The Netherlands was mainly focused on social security programs for unemployment and other labor-market related social risks. Other countries, such as Germany, are just at the beginning of reforming their social security systems. European counties have shown interest in the Dutch reforms because they feel a need for reforming their domestic social security systems. Similarly, the reform process and the new social policies in The Netherlands can provide useful insights for policy makers in countries that are in the process of developing social security systems.

The second distinctive element that caught a lot of attention is the practice of intensive policy coordination between government and civil society. The institutional framework that is in place to coordinate macro-economic and social policy is one of the most distinctive features of the socio-economic model in The Netherlands. The government, unions and employers organizations jointly coordinate - or at least attempt to coordinate - policies regarding wage stetting, labor market regulation, social security and fiscal and tax issues. Many observers believe this institutionalized policy coordination is a key factor in the economic success.

The recent economic success of The Netherlands is indeed remarkable. The unemployment rate is among the lowest in Europe (2.5 percent), net employment growth has been more than one hundred thousand jobs a year since 1997 and the government expects to close this year's budget with a surplus. One can question the direct link that some observers make between the 'Dutch model' and the economic successes, but the 'Dutch model' (also referred to as 'Poldermodel' or 'Delta-model') is interesting enough in itself to warrant a closer look. Before turning to the reform of social security and the Institutions for Policy Coordination, we present the other two elements that are generally considered to be part of the Dutch social-economic model, namely a particular set of economic policies (mainly budgetary consolidation and product market deregulation) and cultural aspects.

It is widely recognized that the trends of globalization, increased macro-economic unpredictability, industrialization, aging, urbanization and changing social patterns, call for the extension of formal social security schemes in East Asian countries to protect workers and their families against the risk of income loss. South Korea has made the most progress with the implementation of insurance schemes for unemployment and disability. But this does not imply that the same social arrangements and institutions that work for Western Europe and seem to work for South Korea are the best option for other countries. There are many ways to promote social security and we therefore explicitly address the question if formal, collective social insurance is suitable for countries such as Indonesia, the Philippines and Malaysia.

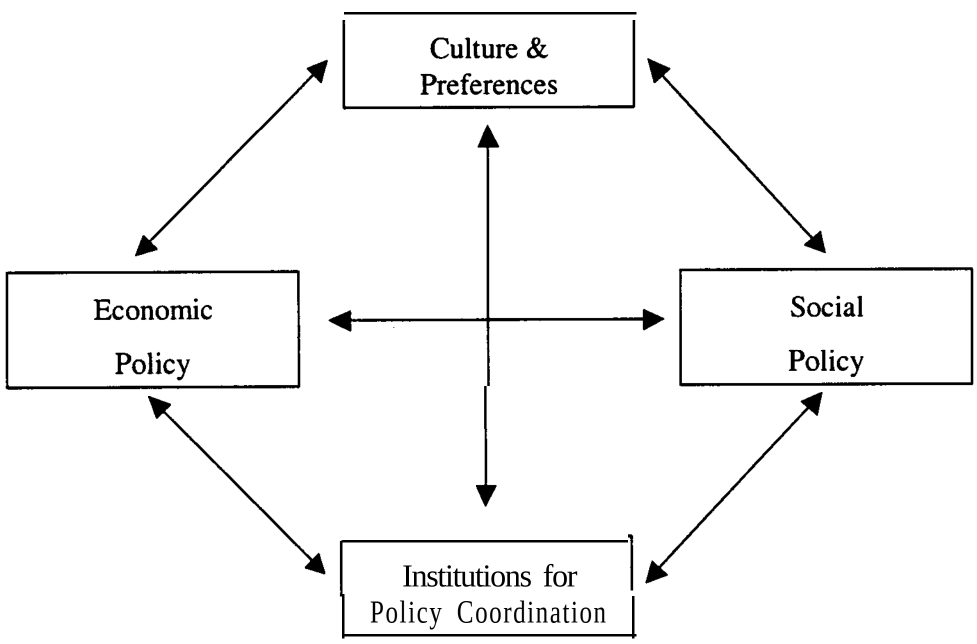
In the next paragraph we introduce the 'Dutch model' and discuss two of it's four components: economic policies and the culture and preferences of the Dutch. In paragraph 3 we discuss the social security reforms and some recent social policies that are part of the social-economic model. We use a framework of labor market flows to structure our discussion. This framework enables us to focus on incentive issues, which where prominent in the reform policies'. In the next paragraph we discuss the Institutions for Policy Coordination and how these institutions contribute to macroeconomic and social policy coordination. We describe the institutions and some key features of the policy coordinating process. In paragraph 5 we address the question if formal social insurance systems of the Western European kind are a workable option for developing countries. We present the idea of individual accounts as a possible alternative. In paragraph 6 we draw the conclusions. Throughout the paper we focus on The Netherlands. Where appropriate however, we refer to experiences in other European countries.

2 -The Dutch model

The 'Dutch model' has attracted a lot of attention from policymakers and academics in Europe. The successes that triggered this attention are extensive and real as The Netherlands now have among the lowest unemployment rates in Europe, high and sustained economic growth, sizeable job growth (around 100.00 per year for the last 4 years) and a budget surplus. The policies that contributed to the current economic prosperity relate to economic issues as well as social issues. In addition the culture and preferences of the people played an important role as these facilitated the economic and social policies pursued. Most commentators agree that the policy coordination institutions are the most distinct feature of the 'Dutch model' and that these institutions are a key element of its success.

In a stylized form the 'Dutch model' consists of four interrelated elements: culture and preferences, economic policy, social policy and institutions for policy coordination (see Figure 1). These elements are interrelated and mutually reinforcing.

Figure 1 — The Dutch social-economic model



[1] Den Butter and Kock (2000) focus on the macro-economic issues of the reform process and pay attention to the trade-off between equity and efficiency.

A coalition government of Christian-democrats and conservative liberals that came to office in 1981 put forward the economic policies that laid the foundation for the current economic success. The economic policies of that administration had three major objectives: budgetary consolidation and monetary stability, wage moderation and the restoration of profits in the private sector. In the 1980s, when budget deficits had mounted to more than 10 percent, budgetary consolidation was a major concern. The process of European monetary unification has gradually turned robust budgetary policy form something actively strived for, into a condition that simply must be met at all times. For the same reasons monetary stability is no longer an issue high on the national policy agenda, but something delegated to the monetary authorities in Frankfurt.

Wage moderation has been a key element of economic policy in The Netherlands and one of they key factors of the success of the 'Dutch model'. The institutions of policy coordination to which we turn in paragraph 4 have facilitated the policy of wage moderation, Throughout the 1980s and the beginning of the 1990s the government has made an ongoing effort to lower taxes and social premiums to support moderate rises in nominal wages.

Wage moderation was indeed very successful, as in the 1980s the total annual wage bill per employee rose by 2.8 percent per year in The Netherlands, compared to 4 percent in Germany (its primary trade partner) and 8.2 percent in the European Union. Wage growth remained low in the 1990s (2.6 percent per year), while in Germany wage increases climbed to an average of 5 percent, partly due to the unification of East- and West Germany*. Wage moderation was the major contributor to rising profits in The Netherlands. To support economic growth and structural change in the economy and in response to changing European legislation subsequent administrations in the 1990s took initiatives to deregulate financial and commodity markets.

An important element of social and economic relations in The Netherlands is the culture of consensus. For major policy changes decision-makers, both in the private and the public sector have a tendency to seek broad support among key stakeholders. This culture of consensus is very prevalent in politics, where administrations are always formed by multi-party coalitions. The tendency to base policies on broad consensus stretches beyond political parties. Important social and economic policy shifts in The Netherlands can only be successful in the long run if they are supported by unions, employers' organizations and other stakeholders in society who are affected by the policy change (Den Butter (2000)). A detailed assessment of a culture of consensus and consensus based policy making in particular goes beyond the scope of this paper[3].

In this paragraph we only briefly discussed the economic policies that are part of the 'Dutch model'. The reason for this limited treatment is that these policies are not all that specific for the Dutch case. Throughout the 1980s Japan also had very moderate wage increases and budgetary consolidation and product market deregulation has been a policy objective in many European countries, although some have been more successful than others have. In this paper we want to focus on policies and institutions that set The Netherlands apart from other countries in Europe. In the next paragraph we therefore focus on the social policies that are an integral part of the 'Dutch model'. Most of the policies relate to the labor market and social security. In paragraph 4 we turn to institutionalized coordination of macroeconomic and social policy, and the institutions that facilitate this.

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[2] Data source: Central Planning Bureau (CPB), MEV publication, several years.

[3] An analysis of one specific European culture is probably not a good starting point for policy lessons in a very distinct culture. It could be worthwhile though to conduct a separate study to the impact of consensus based policy making in general and its social-economic outcomes. Such an exercise could gain some interesting implications for policy making in East Asia.

Before we turn to these topics it is important to stress that the four elements in Figure 1 are mutually reinforcing. The culture and preferences of the people obviously influence social policies. The culture of consensus contributes to stable labor relations that in turn support the development of social policies. Preference for a relatively flat income distribution naturally translates into economic and social policies that supported this. Dutch unions have traditionally placed much emphasis on improving employment opportunities for the unemployed, which clearly contributed to wage moderation and other policies aiming to increase employment (Den Butter (2000)). The culture of consensus led to the development of institutions for policy coordination and the relatively effective way in which unions and employers organizations cooperate in these institutions. When trying to identify if and how elements of the 'Dutch model' can be applied in other countries it is important to keep in mind these dynamic relations between social and economic policy, culture and policy coordination

3 — Social and labor market policy

In this paragraph we focus on social policies implemented in The Netherlands in last two decades. Especially we focus on the adjustments that have been made to the system of social security. Many commentators believe that the reform of the system of social security, combined with policies that aimed to increase labor market flexibility, have contributed significantly to the present success of the Dutch economy (Smith (1999)). As such, the social policies discussed here are an integral part of the 'Dutch model' introduced in the previous paragraph.

The main reason to discuss aspects of the reform of the Dutch social security system is that this will reveal many of the pitfalls and problems that many European social security systems face. Most of these problems relate to adverse labor market incentives. By looking at the reform of particular social security schemes and other recent social policy initiatives one can learn both what precise the adverse labor market incentives are and how these problems can be prevented when social security schemes in East Asian countries are to be introduced or extended. To structure our discussion of the topic we use the framework of labor market flows, as shown in Figure 2.

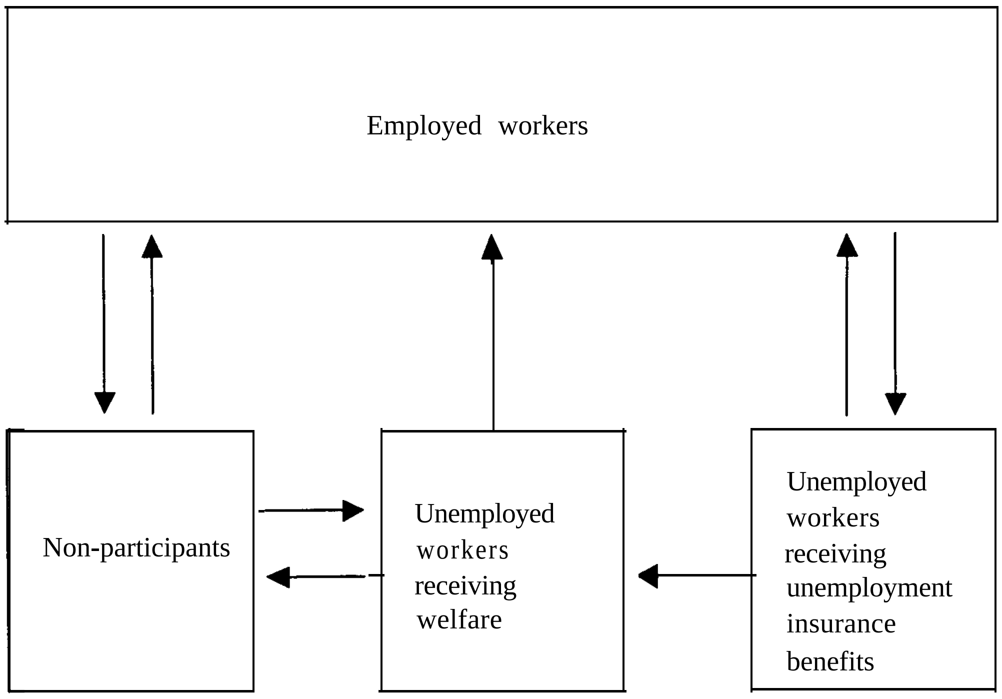
In most European countries there is a two-layer system to protect workers against the consequences of unemployment. Workers who become unemployed are usually entitled to some form of unemployment insurance[4]. Often this is a compulsory collective insurance with benefits levels and duration based on past contributions and employment history. Unemployed workers entitled to unemployment insurance benefits have a recent history of labor force attachment and can be considered short-term unemployed workers. After an initial period of receiving unemployment insurance benefits the entitlement to unemployment benefits expires and unemployed workers become entitled to means-tested welfare benefits (or social assistance benefits)[5]. Welfare benefits are meant to be a benefit of the last resort for workers without (sufficient) unemployment insurance, for households with no source of income or the working poor. Usually the benefit duration is unlimited. In most countries there is a general social assistance scheme, but Germany, France and Spain have a special means-tested unemployment assistance program. The Netherlands abandoned the special means-tested unemployment assistance program in 1996, and introduced a general social assistance scheme[6].

[4] This is why we omit an arrow form 'Employed workers' to 'Unemployed workers receiving welfare benefits' in Figure 2. However, occasionally some workers who become unemployed are not entitled to unemployment insurance benefits and receive welfare benefits.

[5] A means test implies that entitlement to a benefit depends on the level of additional income and sometimes on the stock of assets of the applicant. Means-testing can also be applied to determine the level and duration of the benefit.

[6] The difference between the social assistance scheme for unemployed workers and for persons without employment history usually relates to the type of means-testing, which is typically less tight for unemployment assistance benefits.

Figure 2 — Stocks and flows in the labor market



Persons who are neither employed or unemployed are labeled non-participants (cf. Barro (1997)). The group of non-participants is very diverse and contains disabled workers, retired workers, early retired workers, students and persons who stay at home to take care of young children. While most of the unemployed workers are actively seeking for a job, most of the non-participants are not likely to engage in active job search.

In short, individuals in the working age population can be in one of four labor market states: employment (E) unemployment and receiving insurance benefits (UI), unemployment and receiving welfare benefits (WB) and non-participation (N). Movements in and out of these states ultimately determine the level of employment and unemployment (Pissarides (2000)).

If properly designed, benefit programs minimize adverse labor supply effects. However, many social security programs in The Netherlands and other European countries cause adverse incentives that hamper the functioning of the labor market. The magnitude and the precise form of these incentive problems depend on the institutional characteristics of a social security scheme. For unemployment insurance and unemployment assistance programs, these characteristics are the benefit level and duration, the structure of contributions, entitlement conditions, job search conditions, job acceptance conditions and a possible means test.

We can best analyze these issues by looking at the flows between the different groups'. Inflow into employment is usually described by a so-called matching function. The matching function for the flows into employment in Figure 2 can be written as

$$[1] \qquad M = cV^{\alpha}(S)^{(1-\alpha)},$$

where M is the total number of job matches consisting of matches form unemployed workers receiving unemployment insurance benefits (M_{ui}), unemployed workers receiving welfare

[7] See Broersma, Den Butter and Kock (2000) for an estimation of the size and dynamics of these flows for The Netherlands.

benefits (M_{wb}) and non-participants (M_n), so $M = M_{ui} + M_{wb} + M_n$. V is the total number of vacancies, c denotes the efficiency of the matching process and a denotes the impact of vacancies in the matching process'. S is the total number of effective search units, with $S = \theta_{ui}UI + \theta_{wb}WB + \theta_n N$, where θ is a parameter that embodies a number of factors that determine the impact of an individual job seeker in the matching process. θ is determined by, among others, the effort that individuals put into their job search activities and the wage rate at which they are willing to accept a job that is offered to them (the so called reservation wage). For example, if unemployed workers increase their search activity because the government has lowered the benefit level, we say that the effective number of search units (unemployed workers) increases.

The size of the four stocks is determined by the flows between them and the size of the other stocks. The number of unemployed workers receiving unemployment insurance benefits is determined by

$$[2] \qquad UI = f\left(\underset{(+)}{s}, \underset{(-)}{\pi_{UI \to WB}}, \underset{(-)}{c}, \underset{(-)}{V}, \underset{(+)}{\theta_{wb}WB + \theta_n N}\right).$$

Note that the efficiency of matching (c), the stock of vacancies (V) and the stock of unemployed workers receiving welfare benefits and the stock of non-participants are part of the matching function, which determines the inflow into employment. Obviously, events that raise the number of matches lower the number of unemployed workers receiving unemployment insurance benefits. More vacancies, or a more efficient matching process (e.g. because the government invests in employment services) have a negative impact on the number of unemployed workers receiving unemployment insurance benefits. Because job seekers compete for jobs, a higher number of unemployed workers receiving welfare benefits *(WB)* or more non-participants that actively search for a job tend to raise the number of unemployed workers receiving unemployment insurance benefits. UI rises as the separation rate from employment s raises. If the outflow rate from UI ($\pi_{UI \to WB}$) rises this obviously has a negative impact on the number of workers receiving unemployment insurance benefits'.

Similar relations apply for the number of unemployed workers receiving welfare benefits and the number non-participants. The former is determined by

$$[3] \qquad WB = f\left(\underset{(+)}{\pi_{N \to WB}}, \underset{(-)}{\pi_{WB \to N}}, \underset{(+)}{\pi_{UI \to WB}}, \underset{(-)}{c}, \underset{(-)}{V}, \underset{(+)}{\theta_{ui}UI + \theta_n N}\right)$$

The impact of c and V is similar for the number of welfare recipients as it is for the number of unemployed workers receiving unemployment insurance benefits. WB rises if the number of non-participants and unemployed workers receiving unemployment insurance benefits that effectively search for a job increases. $\pi_{N \to WB}$ and $\pi_{UI \to WB}$ are the flow rates form non-participation and UI into the stock of unemployed receiving welfare benefits, respectively. Obviously, these have a positive impact on the number of unemployed receiving welfare. $\pi_{WB \to N}$ is the outflow rate from the stock of workers receiving welfare benefits to the stock of non-participation.

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[8] In the literature this is referred to as the elasticity of matching.

[9] More precise, the stock of unemployed workers in any period t is determined by the following equation:

$$UI_t = UI_{t-1} + s \cdot E_{t-1} - \pi_{UI \to WB} \cdot UI_{t-1} - c \cdot \left(\frac{V}{S}\right)^a \cdot U_{t-1}$$

The number of non-participants is determined by

$$[4] \qquad N = f\left(\underset{(-)}{\pi_{N\to WB}}, \underset{(+)}{\pi_{WB\to N}}, \underset{(+)}{s}, \underset{(-)}{c}, \underset{(-)}{V}, \theta_{ui}UI \underset{(+)}{+\theta_{wb}}WB\right).$$

The stock of non-participants decreases if the outflow rate to the stock of workers receiving welfare benefits increases ($\pi_{N\to WB}$) and increases if the inflow rate from that stock increases ($\pi_{WB\to N}$). There is a positive relation between the separation rate from employment s and the number of non-participants.

According to a similar logic the number of employed workers is determined by the matching function [1] and the separation rate s[10].

Before we use the above framework to discuss the adverse incentives of some parts of the social security system and the policies that have been employed to address these problems, it is important to point out that social insurance can also have a positive impact on the inflow into employment. Jobs that entitle workers to unemployment or disability insurance are more attractive than jobs that do not offer these benefits. If these benefits are introduced, workers will try harder to finds these jobs and to qualify for them, i.e. they increase their search activity, so the parameter θ increases and the effective number of search units in the labor market rises. Workers will also lower their reservation wages for these jobs, i.e. they accept a lower wage because the job entitles them to unemployment insurance, which is a form of future wages. This so-called 'entitlement effect of unemployment insurance' applies both to unemployed workers and non-participants who search for a job. The magnitude of this effect depends on the precise form of the entitlement conditions.

Policies that influence the flows in and out of unemployment

In the 1980s unemployment in The Netherlands and other European countries rose to dramatic heights and many policymakers started to realize that part of the problem was the high level of benefits and the often long duration of these benefits. High benefit levels lower search intensity and raise the reservation wage, which lowers the number of job matches from unemployment. The high premiums needed to finance the benefits lowered the net wages that in turn had a negative impact on the inflow of non-participants in the labor market.

A number of countries reduced the benefit level and the benefit duration. These policies mainly applied to unemployment compensation schemes and sometimes, as in the Dutch case, to disability schemes. In the 1980s several European governments abandoned annually increasing benefits with wage-inflation. Instead in countries such as the United Kingdom and The Netherlands benefits were now adjusted annually or biannually to compensate for price inflation. The Dutch government even went one step further and in 1983 introduced a one-time cut in the level of all benefits of 3 percent and in 1986 the unemployment benefit was lowered from 80 to 70 percent of a workers wage prior to unemployment. In the 1990s unemployment benefits were reduced in Germany, France and Spain and benefit duration was reduced in Germany and Denmark (Greve (1998)). These measures had the obvious effect of lowering the replacement rate and therefore improving the incentive structure of the system (see Box 1 for information on British policies to increase job search and unemployment outflow).

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[10] Note that the separation rate into non-participation is likely to differ from the separation rate into unemployment.

Box 1 — Policies to increase job search and employment inflow in the United Kingdom

In the United Kingdom, the government has radically changed the unemployment compensation program to improve the incentive structure. In 1996 the Job Seekers Allowance (JSA) program replaced national Unemployment Insurance. Workers who make sufficient contributions are entitled to an income-related benefit, for a maximum of six months. Unemployed workers who are unemployed for longer than six months or do not meet the contribution criteria are entitled to a flat rate, means-tested benefit. Eligibility of the JSA dependents on the worker being unemployed, capable of work, available for work and actively engaged in job search. JSA includes an element of active labor market policy, as claimants have to sign a job seeker's agreement in which future actions are listed to find employment. In this way the government hopes to increase search intensity and raise the inflow into employment.

At the end of the 1980s and in the beginning of the 1990s a large number of empirical studies was published that addressed the relation between the benefit level and duration and the outflow rate from unemployment. In a study for The Netherlands Van den Berg found that the outflow rate of unemployed workers who receive unemployment insurance benefits increased significantly when their benefit duration was about to expire and they would receive much lower welfare benefits (Van den Berg (1990)).

In an influential study Layard, Nickel and Jackman (1991) suggested that the maximum benefit duration is perhaps a more important determinant of the outflow rate from unemployment than the benefit level.

The negative relation between unemployment duration and the average outflow rate is due to two separate factors: heterogeneity and duration dependence. The heterogeneity effect implies that unemployed workers with the best characteristics have a higher outflow probability. This implies that after a positive labor demand shock (i.e. a rise in the number of vacancies), the average quality of the group of unemployed workers is worse than prior to the shock. The duration dependence effect implies that workers' skills deteriorate if they are unemployed for a long time. Furthermore they become disillusioned and discouraged and this has a negative effect on their search effort. These mechanisms may lead employers to rank unemployed workers according to their unemployment duration. An important conclusion is that due to these mechanisms the unemployment outflow probability declines as the duration of unemployment increases.

In the 1990s many countries have tightened work- end job search requirements to increase the overall outflow rate from unemployment. Some groups, such as lone mothers who had thus far been exempted from job search, are now required to search for a job (see Box 2 for examples). One of the main reasons for these policies is to prevent a deterioration of human capital.

Countervailing incentives to alleviate the consequences of adverse incentives of social security programs can be introduced in a number of ways. An obvious way is to introduce outflow premiums for unemployed workers. The impact of this policy depends on the level of the premiums and in part on the tightness of the labor market (the number of unemployed workers relatively to the number of vacancies). If very few vacancies are available, a relatively small premium is unlikely to have sufficient impact on the search effort and the reservation wage to significantly increase the inflow into employment. A disadvantage of this policy is that it involves deadweight loss because one cannot distinguish a priori between workers that actually need the incentive and workers who would have found and accepted a job anyway.

In most countries the two tier system of unemployment insurance benefits and welfare implies that there is only one moment during the entire spell of unemployment when the benefit level is decreased, namely when unemployment insurance benefits expire and the unemployed worker becomes entitled to the much lower welfare benefit. The notion that the outflow rate from unemployment insurance increases at the end of the benefit period and the fact that the search effort of unemployed workers declines with unemployment duration, induced proposals to lower unemployment benefits step by step, during the unemployment spell. Several theoretical models of optimal unemployment insurance also suggest that benefits should decline with unemployment duration. Countries such as France, Belgium and Spain have introduced a model of declining levels of unemployment benefits (Schmid and Reissert (1996b)). As far as we know, there are no evaluations available of these social security programs, but it is likely that this will increase the search effort and the job acceptance probability, therefore raising the outflow rate from unemployment. If these measures reduce the average unemployment duration, the skill level of unemployed workers will deteriorate less and this will improve the overall functioning of the labor market, i.e. raising the matching efficiency c in the model presented above.

Box 2 — Tightening work requirements for lone mothers in the United Kingdom and The Netherlands

In the United Kingdom lone-mothers are not required to search for a job. Recently the British government tightened this policy. A lone mother is now required to attend a job search interview, where she will be advised to enter the labor market, when the youngest child reaches school age. However, she is not required to enter the labor market, as long as she is raising one or more children under the age of sixteen (Connolly and Munro (1999)).
Last year the Dutch government went one step further, as it proposed to completely abandon the exemption from job search requirements for lone-mothers. In The Netherlands, lone-mothers with children in primary-school age were already required to engage in job search, but lone-mothers with children aged 0 to 5 years, have been exempted from job search requirements so far. The measure will come into force next year. A part-time job is sufficient to fulfill the work requirement, and the job search requirement is conditional on the availability of nearby subsidized child-care facilities.
Given the tight labor market in The Netherlands, there is a debate going on to abandon exemptions from work- and job search requirements for other groups too, for example for unemployed workers aged 57.5 years or older.

Policing individual (job search) behavior has always been an element of virtually every social security program and in recent years this strategy to reduce the adverse incentives has become increasingly popular in Europe. This is partly due to a shift in political preferences. Counseling and monitoring is one of the policies that aim to increase the job search effort of unemployed workers. The impact of this policy on the unemployment outflow rate depends on the structure of the program and the target group. If counseling and monitoring implies only limited assistance to the unemployed worker, e.g. only one interview per two years, as is often the case in The Netherlands, than the impact is negligible (Van der Klaauw (2000)). Most studies find that counseling and monitoring could be an effective policy to alleviate adverse incentives in the unemployment assistance scheme, especially if they are targeted at long term unemployed workers with an unfavorable labor market position. Punitive sanctions could be a successful policy with respect to both unemployment insurance benefits and unemployment assistance. The sanction usually implies a temporary benefit cut. Especially in The Netherlands sanctions are a widely used instrument. In 1997 a punitive sanction was imposed for 36 percent of all unemployed spells. However, the best strategy turns out to be a combination of intensive counseling and monitoring and punitive sanctions.

Policies that influence the flows in and out of non-participation

Over the years, especially in the 1980s when unemployment in Europe was high, governments have used social security programs to create employment opportunities for unemployed workers. Most of these policies promoted labor market exit for older and disabled workers (i.e. raising the separation rate s into non-participation). Casey (1996) distinguishes three types of these policies[11]:

1. Early retirement pensions for the unemployed;
2. Special voluntary early retirement schemes;
3. Disability benefits adapted to labor market purposes.

In some countries expenditure on this type of policy has been substantial (see Table 1). Denmark and Germany, for example, respectively spent 1.41 and 0.49 percent of GDP on these policies in 1994. Sweden on the other hand, spent only a fraction, 0.02 percent of GDP.

The results of these policies are mixed, but most seem not very successful. In Table 1 it is shown that British, France and German programs were relatively successful in terms of filling the vacancies created by the programs. The replacement rate was 80 percent or higher. But in Denmark less than 50 percent of the vacancies created by the Early Retirement Program was filled. The differences arise because replacement was obliged in the British, France and German programs and it was not in the Danish and Dutch programs. More important from a policy point of view is the reduction in the number of registered unemployed workers that was actually the result of these programs. The Dutch Early Exit scheme was extremely unsuccessful, as on average only 25 percent of all replacements was made from among the ranks of unemployed workers. The unemployment reduction coefficient of the British Job Release scheme is extremely high (93 percent) because it was required that created vacancies were filled by registered unemployed workers. Differences between replacements made and actual unemployment reduction are due to recruitment from among non-registered unemployed workers, recruitment that was not sustained and recruitment that would have occurred in any case, i.e. deadweight loss (Casey (1996)). Overall, only the British program can be considered successful, as unemployed workers replaced at least 79 percent of the workers that moved to early retirement. The disappointing results and lower unemployment rates has caused some countries, such as The Netherlands, to shift away from these types of policies.

Table 1 — The success of social security programs to create employment opportunities

	UK (Job Release)	Netherlands (Early Exit)	France (Solidarity Contracts)	Germany (Pre-retirement)	Denmark (Early Retirement Pay)
Effective replacement rate	85-90	66[a]	95	50 or 80[b]	25-50
Unemployment reduction coefficient	93	25	50-65	60	
Success rate	79 - 84	17[a]	48 - 62	30 or 48[b]	

Source: Casey (1996) and own calculations.
Notes: The name of the program is between parentheses. See Casey (1996) for details. The success rate is defined as the product of the effective replacement rate and the unemployment reduction coefficient.
[a] Including internal transfers.
[b] 50 percent reflecting replacement recruitment's, 80 percent including redundancies avoided.

[11] Casey also mentions continued payment of unemployment benefits and relaxation of registration requirements that were discussed in the previous section.

Mixed policies to increase the matching efficiency and the unemployment outflow rate

Recent policy developments combine several of the policy elements mentioned before, such as punitive sanctions, premiums, monitoring and counseling, job search assistance and training. The Dutch ‘single-wicket’ approach is an example of this comprehensive type of social policy. Some of these programs are based on the Wisconsin project in the United States, such as the Workforce project in Amsterdam (Kock (2000)). In this program the local social security administration (responsible for administrating and executing the social assistance scheme), the employment office and a number of private companies engaged in a public-private partnership, which aims to reduce the number of social assistance beneficiaries in one of the most disadvantaged neighborhoods of the city. The program integrates active and passive labor market policies, which is al the more important in The Netherlands because employment offices have no role in providing unemployment insurance or social assistance. In this way it is hoped that the overall matching efficiency in the labor market improves. The central concept, the so called ‘single wicket concept’, implies that unemployed workers are allocated to one civil servant, who deals with both benefit issues and a range of active labor market programs. All services are available in one single office, hence the name ‘single wicket’. The main goal is to bring the unemployed workers back to regular work as soon as possible, thereby preventing loss of human capital. The Workforce office and the unemployed worker close a contract stating their mutual obligations. Together they make a comprehensive plan, including all actions that have to be taken to prepare the unemployed worker for regular employment. A range of services is available from the Workforce office: childcare facilities, training facilities, debt relief programs, mental care and language courses (a large portion of the non-native unemployed workers in the neighborhood has very limited knowledge of the Dutch language). Counseling continues until six months after the worker has found a job, to prevent him from falling back into unemployment.

In this paragraph we have focused on the adverse incentives arising form some of the social security programs and we addressed some of the policies that have been adapted to address these problems. However, social security also has an important positive impact on economic efficiency. Korpi (1985) has described this as the ‘irrigation function’ of social security[12]. In this view there is a positive relation between social security and economic efficiency because a lack of social security could hamper a dynamic economic development. Partly due to social security, workers are not forced to accept or hold on to inefficient jobs and slow down the process of job creation and job destruction. Temporary unemployment might be unavoidable in this process of job moving and structural change.

4 — Institutions for policy coordination

The final, and perhaps most distinctive element of the ‘Dutch model’ that we discuss are the Institutions for Policy Coordination (IPCs). Policy coordination played an important role in the design and implementation of many of the social policies discussed in the previous paragraph.

To coordinate macroeconomic and social policy a number of institutions are in place in The Netherlands. An important feature of most of these institutional bodies is that, although they are based on national legislation, they operate independent from the government. Most of the IPCs have a broadly defined advisory and coordinating task, relating to medium-term social and economic policy. Issues include product market regulation, social security, labor and industrial relations and legislation, worker participation, the relation between the labor market and education, European policy, environmental planning and transportation, sustainable

[12] See Den Butter and Kock (2000) for a short theoretical assessment the ‘irrigation function’ of social security and how social security can enhance welfare.

development and consumer affairs. An important feature of the Dutch model is that macro-economic and social policy coordination also includes the development of the wage level in the private sector in relation to the overall economic development and in particular the competitiveness of the exporting industries.

The advantages of a good system of national macro-economic and social policy coordination are manifold. By coordinating its actions with other parties in the economy the government can enhance the effectiveness of its policies. Because all stakeholders cooperate in the development of social and economic policies they feel responsible for the successful implementation of these policies (Den Butter (2000)). And by coordinating their individual policies, such as wage setting by unions and employees and labor market regulation by the government the risk is limited that a particular policy of one of the stakeholders is counteracted by the actions of another. If the government wants to promote human capital accumulation, for example, it can grant individuals tax deductions for tuition or course fees. This policy becomes more effective if the government coordinates with employers and unions and persuades them to use part of the annual increase in productivity and profits for investments in human capital accumulation too, instead of wage increases. In the 1980s one of the main goals of economic policy in The Netherlands was to restore profits in the private sector, or to lower the total wage bill as a share of total private earnings. To facilitate wage moderation the government developed a policy of general and targeted tax cuts and coordinated with unions and employers.

Coordination of macro-economic and social policy between the government and private parties can prevent or mitigate social unrest. Regular and institutionalized policy coordination also increases the scope to achieve policy objectives through voluntary action in the private sector rather than through government legislation. In The Netherlands, but also in other European countries, the government and the private sector have made comprehensive agreements to reduce particular types of environmental pollution. In these agreements the government commits the private sector on the goals and a timeframe to reduce pollution, but abstains from detailed instructions on how to achieve these goals, thereby giving the private sector the possibility to seek for the economically most efficient way to meet the goals.

The most important IPCs in The Netherlands are the Social and Economic Council, the Labor Foundation, The Netherlands Bureau for Economic Policy Analysis and the Central Economic Commission. We discuss them below.

Social and Economic Council — The Social and Economic Council (SER) is the main advisory body of the Dutch government for social and economic policy issues. Although instituted by law (in 1950), the SER is not a government body[13]. Three groups are represented in the Social and Economic Council: representatives of trade unions, representatives of employers' organizations and independent (crown) members, appointed by the government. Crown members are independent experts, often university professors in economics, finance, law or sociology. The government appoints them, but they are not accountable to the government. Because many of the potential crown members are in fact associated with a political party or at least are known for particular political opinions, with each appointment special care is taken to maintain a fair balance between the various fields of interest and the political views in the country. In practice this implies that the crown members reflect the balance of power between the four major political parties in The Netherlands (labor party, christiandemocrats, conservatives and liberals). The tripartite composition of the SER reflects the social and economic relations in The Netherlands, where unions, employers' organizations and the political

[13] The SER is financially independent of the government. Employers pay a mandatory annual contribution by industry through a tax to the Chamber of Commerce.

elite (through the crown members) coordinate, inform and guide macro- and social-economic policy.

The SER can give advice, solicited or unsolicited, on all major social and economic affairs. The government is not obliged to follow the SER's advice. In order to carry out its proposed policy the government needs widespread social support. By asking advice from the SER, the government can learn if sufficient support is present among the unions and employees. Unanimous advice indicates broad-based support but when opinions are divided the government understands that there is a lack of support in major parts of society. The arguments put forward by the SER are also used by parliament in its debate with the government.

Labor Foundation -Another important Institution for Policy Coordination in The Netherlands is the Labor Foundation, which consists of representatives of unions and employers' organizations. The main aim of the foundation is to promote good labor relationships between unions and employers' organizations. The discussions in the Labor Foundation are an important input for the meetings in the Social Economic Council. Perhaps the most important asset of the Labor Foundation is the biannual meeting with the Cabinet. In spring and fall the Cabinet and the Labor Foundation discuss major social-economic issues, mostly regarding social security, wages and some aspects of fiscal and budgetary policy. In theses meetings the Cabinet, unions and employers' organizations try to agree on guidelines for the upcoming negotiations of Collective Labor Agreements. These collective agreements determine the overall nominal wage increases at the industry level. Although the parties involved in the spring and fall meetings usually do not reach an agreement on this, the meetings are important for policy coordination. The meetings facilitate the exchange of information, increase transparency about the opinions of the different parties and help to form expectations on which unions and employers' organizations base their position in the wage negotiations.

***Netherlands Bureau for Economic Policy Analysis* —** The Netherlands Bureau for Economic Policy Analysis (CPB) combines two tasks which in other European countries tend to be separate: it is the accounting center for budgetary and economic policy and it is a research center preparing independent forecasts and analyses on a wide range of economic issues.

The CPB assesses policy options for all ministries, parliament, trade unions, employers' organizations and other parties in civil society. This clearly facilitates policy coordination as all parties have the same information and their inputs in the policy debates are based on the same assumptions regarding economics growth, inflation, unemployment and other relevant variables. Another important task of the CPB is to conduct a quantitative and qualitative assessment of the economic impact of the policy proposals that political parties make prior to national elections. Using advanced econometric models, the CPB calculates the impact of the proposals in the election manifestos of the major political parties on employment, wages, economic growth and the government budget. This forces the parties to use uniform and realistic assumptions and enables voters and civil society to make comparisons between the proposals of the parties. The assumptions on which the calculations are based and the model used for the quantitative assessment are the same as those used to evaluate policy options for the cabinet and to calculate the budgetary impact of the cabinet proposals. This facilitates the translation of the proposals in the election manifestos into government policy after the elections. This is an important asset because The Netherlands always has a coalition government of two or three parties. The CPB's analysis and forecasts are also an important input fort the Social and Economic Council (SER).

The CPB is part of the Ministry of Economic Affairs but it has a strong independent position. Independence is essential because the 'clients' for whom the CPB does policy assessment often have different interests. Because the CPB does policy assessment for other ministries it is important to secure an independent position form the Ministry of Economic Affairs. Ministries sometimes have contrasting interests. The Ministry of Finance and the Ministry of Social

Affairs for example might think different about government contributions to the Social Insurance Funds. Because The Netherlands has a system of coalition government, political conflicts of interests might arise between ministers of different parties in the Cabinet. This stresses the need for independence of the CPB.

The independence of the CPB is best safeguarded by the scientific quality of its work. Many of the staff members and senior management come from academia or are affiliated to universities. There is extensive and frequent interaction between the CPB and the economic faculties and they often engage in joint research. The CPB secures the scientific quality of its work through an independent advisory committee of university professors and regular quality assessments. The scientific work of the bureau, such as the models used for policy evaluation, is published in international academic journals and presented at international conferences. The reports it produces are in the pubic domain and open for comments by the public and the scientific community. Media attention for the CPB's assessments is usually high. All of this contributes to the independent position of the CPB, which is essential to perform its role in the process of policy coordination.

Central Economic Commission — The Central Economic Commission (CEC) is the most important advisory and policy coordination body within the government with regard to social-economic issues and public finance. The commission consists of the secretary-generals (the highest ranked civil servant) of the Ministries of Economic Affairs, Finance and Social Security and Employment Policy. The Dutch Central Bank and The Netherlands Bureau for Economic Policy Analysis are also represented in the commission. The CEC prepares and coordinates cabinet policies and as such functions as the main porch of many meetings of the Cabinet. The fact that a number of ministries, the Central Bank and the CPB are involved facilitates the internal macro-economic and social policy coordination for the national government. It also contributes to the coordination of the input that the national government has in other institutions for policy coordination, such as the Social and Economic Council.

Informal and frequent contacts are important for the effectiveness of the IPCs. In fact, a limited number of high ranked officials occupy the seats in the different bodies. Government departmental representatives attend all public council meetings and closed meetings of the commissions and working parties of the Social and Economic Council in their capacity of observers. The president of the Central Bank and the director of the CPB perform a special role, as they are also independent crown members of the SER and members of the Central Economic Commission.

IPCs also play an important role in the political process. Politicians 'use' the advice produced by the SER and the CPB to prepare the public for unpopular decisions. A minister, knowing more or less what the outcomes will be, may ask the CPB to calculate a particular forecast or the impact of a particular policy and use the outcomes as leverage in the decision making process with parliament, the cabinet or even within the minister's own political party to establish a majority coalition for a particular unpopular measure.

In essence the advantages for a country of having a well functioning system of Institutions for Policy Coordination is that it enhances its capacity to deal with short-term economic shocks and structural change. The many formal and informal interaction between key players in the policy field help to build trust and mutual understanding. It helps to create an environment where policy discussions are open and extreme and inflexible standpoints can be avoided.

It is too simple to think that simply implementing the elements discussed above in East Asian countries will generate the same favorable outcomes as in the Dutch case. The bare fact that the cultures are very different prevents us from taking this simplistic view. It is quit thinkable though that the community-oriented culture in many East Asian countries could provide a fruitful basis for more intense policy coordination between the government and other parties in the economy.

5 — An alternative for collective social security schemes

In the previous paragraph we discussed social security policies in The Netherlands. In developing their own unemployment, disability and health insurance schemes, East Asian countries can learn form the policies that have been developed to deal with the adverse incentives that seem to be an inevitable part of social insurance schemes in Western Europe. They question is however if these collective social security schemes are feasible in East Asian countries, given the very different social and economic circumstances.

The International Labor Office (1998) thinks they are. This organization states that with very low contribution rates (0.3 – 0.4 percent of the pay role) a sustainable system of unemployment insurance could be introduced in the five East Asian crisis countries. This would cause very little effects on labor costs and labor demand. However, the pitfall is not so much the costs per se, but the combination of costs and disincentives, such as the ones discussed in paragraph 3. Successful strategies have in common that they recognize the incentives faced by individuals and institutions. Many of the adverse effects of social security programs in European countries are not caused by the bare existence of these programs or the burden they impose on the economy, but because of the inappropriate design of these programs. Therefore East Asian countries should carefully assess the design of social security programs. The challenge is to develop cost effective and sustainable social security programs that do not produce the adverse effects seen in some of the Western European countries.

Ahmad (1991) on the contrary concludes that if it is not feasible to administer unemployment insurance programs in the informal sector in East Asian countries, and if the objective of these programs is to provide a safety net, then formal unemployment insurance is not the best option for developing countries with a high share of informal employment. Many vulnerable workers in East Asia are in the informal sector, especially in Indonesia. The question is how to help these workers with a formal social security system. Introducing formal social security programs will make working in the formal sector more attractive and therefore induce a shift from the informal to the formal sector. But it seems wishful thinking that this variant of the 'entitlement effect of social security' that we discussed before would be very large.

As problems with the administration of formal social security schemes in the informal sector are indeed likely to be enormous in countries such as Indonesia, the Philippines and others, it is unlikely that introducing formal social security schemes of the European type could establish a comprehensive system of social protection for all workers in East Asia. Another option for East Asia might therefore be the establishment of individual accounts. Table 2 lists some of the feature of the idea for individual accounts as it has been put forward by Feldstein and Altman (1998)[14].

A system of individual accounts with characteristics such as listed in Table 2 will improve incentives and in general increase utility. On the other side, it could increase inequality among workers with a high and a low probability of (long-term) unemployment (Orszag et al. (1999)). However, some form of solidarity will remain. At least negative balances will be forgiven at the moment the worker reaches retirement age. Furthermore it seems advisable to have some form of compensation for workers that come to face negative balances early in their career, to prevent them from being locked-in in this situation. For example, these workers could be granted welfare benefits that are financed out of general taxes.

[14] See Kock and Den Butter (2000) for more details about this idea.

Table 2 — Some characteristics of individual accounts

Contributions and withdrawals

- Every worker contributes a percentage of the wage to a personal saving account.
- Contributions are mandatory until a certain capital has been accumulated in the individual account. When this threshold level of capital has been accumulated, contributions may be stopped.
- Unemployment benefits are being paid out of the savings account according to certain withdrawal rules, which could be similar to some of the social security schemes in Western Europe.
- Positive balances are added to the worker's pension rights when the worker reaches retirement age or are bequested if the worker dies before he or she reaches retirement age.

Debit and credit balances

- The account balances can be invested into stocks and bonds
- When the account balance is inadequate to pay unemployment benefits, the government pays the benefits and debits the worker's account by the same amount.
- Positive account balances generate an interest and the government charges the same interest rate to cover for negative balances.
- Negative balances are forgiven when the worker retires or dies.

An important advantage of a system of individual accounts is that it reduces the disincentives that are caused by collective unemployment insurance because workers take into account the costs of unemployment benefits. Under individual accounts the search effort and job acceptance probability of workers will increase, which will lead to a decline in the unemployment rate. Individual accounts are primarily aimed to increase unemployment outflow. Additionally, it can be expected that unemployment inflow will slow down. The costs of being unemployed will rise and the reward for employment will be higher, which will cause labor force participation to rise, both measured in hours worked and in persons. This will also positively influence the employment inflow of groups that are currently not obliged to search for employment, such as lone mothers receiving welfare.

Cox Edwards and Manning (1999) indicate that individual accounts could work well in developing countries if workers are given a choice to contribute to their accounts or not, thereby choosing between formal and informal income security. Certainly individual accounts are an option for East Asia. Singapore already has a system of individual accounts to provide social protection to a large share of the population. Individual accounts are used to finance a number of social security schemes (see Ministry of Economic Affairs (2000) and Connolly and Munro (1999)). There is one compulsory, individual saving account for workers, the Central Provident Fund, which pays disability and retirement-pensions. Employers and employees each contribute 20 percent, depending on minimum and maximum contributions. Workers use their account to pay unemployment benefits, disability pensions, retirement-pensions and costs for health care. Within certain limits, workers can withdraw positive balances when they reach the age of 55. At retirement age all positive balances can be added to the retirement pension scheme. After the introduction of the system in 1955, rules for withdrawal have been relaxed. Now it is possible to use positive balances to invest in a house, government bonds or stocks. Parents are also permitted to finance loans for their children's education from their account.

6 — Conclusions

In this paper we presented the Dutch social-economic model that has proved so successful in recent years and attracted much attention from policymakers, politicians and civil society in Europe.

Perhaps the most distinct feature of policy making in The Netherlands is the role of formal Institutions for Policy Coordination. In The Netherlands the social partners and the government engage in regular, institutionalized consultations to discuss issues relevant for economic growth, employment and social welfare.

A well functioning system of institutions for macro-economic and social policy coordination is a valuable asset for countries to deal with economic shocks and structural change. Given its causes, the Asian-crises could probably not have been avoided had a comprehensive system of IPCs been in place. Macro-economic and social policy coordination is important however in the immediate aftermath of the crisis and in the process of recovery. It could help building consensus for government policies to deal with the crises, such as alleviating particular commodity subsidies and other measures that seek budgetary consolidation. Institutions for policy coordination might also guide the adjustment of real wages after the shock by coordinating wage demands form the private sector and government policies that influence the price level and hence the real wage rate.

Recently Korea, Singapore, the Philippines and Malaysia have shown examples of social dialogue and tripartite commitment on a number of labor market policies and active labor market programs (Campbell (2000)). Policy coordination can prove an important tool when the economies of the Asian countries continue to mature and wage pressure builds up. Institutions for policy coordination can than facilitate wage moderation, which could help these economies to maintain competitiveness. Further research is needed to investigate in what way the present cultural, political and institutional setting in East Asian countries provides a basis to develop new and expand existing institutions for policy coordination

Institutions for policy coordination facilitated the social-economic reforms in The Netherlands that took place during the last two decades. The Dutch experience learns that in redesigning social security systems or facilitating macro-economic adjustment, a dialogue between unions, employers' organizations and the government can be a valuable asset. The Netherlands is a leading country in Europe in the restructuring of social security and promoting labor market flexibility.

The Dutch experience shows that it is important to pay close attention to the macroeconomic costs of social security. But many of the adverse effects of social security programs in European countries are not caused by the bare existence of these programs or the burden they impose on the economy, but because of the inappropriate design of these programs. It is therefore equally important to make sure that the underlying micro-economic incentives of the programs do not hamper labor supply or the functioning of the labor market (i.e. the matching of vacancies and job seekers). This is crucial for the long run sustainability of any social security system.

If East Asian countries choose to introduce or extend formal, collective social insurance schemes they should carefully assess the design of these programs. The challenge is to develop cost effective and sustainable social security programs that do not produce the adverse effects seen in the Western European countries.

For counties with a high share of informal employment, this strategy to protect workers form the consequences of income loss might not be the most appropriate. Workers in the formal sector would benefit from formal social security programs of the European fashion. If these social security schemes are combined with active labor market policies maybe also workers in the informal sector could benefit. Some elements of the Dutch 'single-wicket' approach are worth considering. For example, when introducing or expanding formal social security programs, it is worthwhile to consider if and how they can be integrated with current activities of public employment offices and some labor market activities of NGOs and civil society.

Formal collective social insurance is not the only way to protect workers form social risks. Some have suggested individual accounts as an alternative to the existing social security schemes in Europe. There is no reason however why countries that are building a social safety net for their workers should a priori choose a particular blueprint. Individual accounts and collective social insurance each have their pros and cons, and developing a system of social security that combines these two approaches could very well be the best way to pursue for countries that are in the process of developing social security.

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